Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	)	CC Docket No. 01-338
	)	
Implementation of the Local Competition Provisions of the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Deployment of Wireline Services Offering Advanced Telecommunications Capability	)	CC Docket No. 98-147
	)	

DECLARATION OF JAMES N. PERRY, JR. IN SUPPORT OF THE REPLY COMMENTS OF THE COMPETITIVE TELECOMMUNICATIONS ASSOCIATION

1. My name is James N. Perry, Jr. I am a Managing Director at the private equity firm of Madison Dearborn Partners ("MDP"), 70 West Madison, Suite 3800, Chicago, IL 60602. MDP is a private equity firm, specializing in providing equity capital to private companies in various stages of development, in both start-ups as well as companies that are further developed. Throughout its 20 year history as a private equity firm in the telecommunications sector, MDP (and its predecessor company First Chicago Venture Capital) has prospered by investing in businesses that in many cases other investors consider to be too risky or even "destined for failure." For example, we were early investors in the cable television and commercial mobile wireless sectors of the communications industry.

2. As a result of our earlier success in other parts of the communications industry, when Congress passed the Telecommunications Act of 1996, MDP

was receptive to the signal from Congress and the Administration that their should be local telecommunications competition in the United States. MDP responded to this policy change by becoming an active investor in competitive telecommunications carriers. Currently, through our four active funds, MDP has invested well over $1 Billion in competitive telecommunications carriers. Since 1996, MDP has invested in a variety of competitive telecommunications carriers, including local and long-haul wholesale, and retail competitive local exchange, carriers.

3. The Competitive Telecommunications Association ("CompTel"), of which most of MDP's telecommunications service provider portfolio companies are members, asked me to explain whether a decision by the FCC in this proceeding to eliminate, or phase out, an unbundled network element would stimulate competitive investment in telecommunications infrastructure. To put my views into perspective, it is helpful to explain a little more about MDP and the way we analyze and manage our investments.

4. As a private equity investor, MDP raises pools of capital from primarily large institutional investors such as college and university endowment funds, and public employee pension funds. Once a fund is created, and an investor commits its capital and becomes "limited partner" in the fund. The principals of MDP are the "general partners" in the investment partnership. MDP must, for its part, identify investment opportunities, make investments in these companies, manage these investments, and, ultimately, successfully convert the fund's equity share into a more liquid asset (such as cash or stock in a

publicly-traded company), which is then distributed among the fund's limited partners. MDP is not successful unless we can, over the life of a fund, realize capital gains for our limited partners' investments.

5. Typically, MDP will "draw down" or invest the collective capital of a fund over a 6 year period. While we will ideally try to get a return on the capital within 5-7 years, we have, on occasion, extended the life of a fund to 10-13 years if doing so was necessary in order to successfully realize a capital gain for our limited partners. Thus, the time horizon for investors funding facilities-based competitive networks is longer than the three year period within which the FCC has undertaken to conduct its periodic reviews of the availability of certain network elements.

6. While MDP is always evaluating new investment opportunities on behalf of both its limited partners, and its existing portfolio companies, MDP is currently focused on managing primarily five substantial portfolio companies in the competitive telecommunications service provider sector. Four of these companies, Allegiance Telecom, Cbeyond Communications, Focal Communications, and PaeTec Communications, are retail competitive local exchange carriers ("CLECs") who provide integrated communications services (local, long distance, voice, and data) to small, medium, and large business customers. One other portfolio company, Looking Glass Networks, provides local metro fiber transport services to other telecommunications carriers.

7. When considering whether to make an investment in a competitive telecommunications provider, MDP considers several factors. First, we look at the investment candidate's business model, the economics of the proposed business, the opportunities for quickly developing the business into a substantial enterprise, and the expected return on the investment.

8. Next, we assess the previous experience of the management team. A company with a management team that has been successful with previous types of ventures is a more likely candidate for MDP's capital.

9. Finally, we assess the external risks to the company—the competitive risk, and the regulatory risk. To analyze the competitive risk, MDP looks at the size of the market the company is seeking to enter, as well as the number of firms that are currently competing in that market, and the financial performance of those firms. Determining regulatory risk is similar, but involves primarily conducting an assessment of the carrier's regulatory dependence, and whether the existing regulatory environment will facilitate the proposed business model. At the time we made our existing investments in competitive telecommunications carriers, Congress, the Administration, and the FCC, had formally adopted a policy of affirmatively encouraging telecommunications competition, so the overall regulatory climate seemed favorable. Neither MDP, nor other investors in competitive carriers, anticipated that laws, and the rules implementing them, would change in any substanital way. Rather, our expectation was that government's pro-competition policy would remain stable for a long time.

10. The passage of the Tauzin-Dingell bill by the House of Representatives and the introduction of the Breaux-Nickles bill in the Senate, combined with the initiation of several proceedings at the FCC that appear designed to favor incumbent monopolies over competitors, has substantially changed MDP's view of the regulatory risks associated with investing in competitive telecommunications carriers. Thus, MDP is now concerned that the government may be presently inclined toward the historically-discredited, mercantilist model of providing services to consumers; in other words, the government would effectively protect monopolies from competition, in exchange for some modest future benefits promised by the monopolists. As a consequence of the recent increase in regulatory risk, it is now impossible for companies with any "regulatory dependence" to raise capital.

11. While MDP understands the importance of minimizing its portfolio companies reliance on incumbent local exchange carrier ("ILEC") unbundled network elements ("UNEs"), all of our portfolio companies have some critical dependence, direct or indirect, on ILEC UNEs. Allegiance, Cbeyond, Focal, and PaeTec, as a group, use or intend to use primarily high capacity loops (DS1 and DS3) and transport (DS1 and DS3). Allegiance also uses some 8db analog loops. While each of these companies uses, to the maximum degree possible, competitive transport facilities where these facilities are available, none has been able to completely eliminate its dependence on ILEC facilities for interoffice transport. Similarly, while Looking Glass uses entirely its own facilities to directly provision its competitive transport service, it is equally

dependent (albeit indirectly) on ILEC UNEs, as each of its CLEC customers requires continued access to some ILEC UNEs.

12. As previously stated, I was asked by CompTel to address what would be the likely effects of a Commission decision to eliminate access to one or more ILEC UNEs as part of its Triennial UNE Review proceeding, and whether the elimination, or phase out, of a particular ILEC UNE would stimulate greater investment in facilities by competitive carriers. I will first address the likely effects of the elimination, or phase out, of an ILEC UNE on which any of our portfolio companies currently depends.

13. If the FCC were to determine that a critical element for our portfolio companies, such as loops or transport, was no longer a UNE subject to mandatory unbundling obligations, then the competitive carrier would need to switch to higher priced ILEC special access service. This would have the immediate, and obvious, effect of increasing the carrier's operating costs, and thereby reducing the carrier's gross margins (revenue minus cost of goods sold).

14. The other, less obvious, effect of requiring competitive carriers to purchase higher priced special access service instead of ILEC high-capacity loops and transport is that the competitor may not be able to mitigate the effects of this exogenous cost increase by passing it through to its customers. This is not only because competitive carriers must price their services competitively with ILEC retail rates (which can be below special access rates), but also because competitive carriers will frequently be required to guarantee the competitive

price over a term of years with the retail customer. Were the Commission to raise costs for competitive carriers through the elimination of UNEs, many competitors would still be obliged to continue providing service to their customers under term contracts based on UNE prices. This would exacerbate the constriction of gross margins described above.

15. The significance of gross margins being dramatically eroded as the result of losing direct access to critical UNEs is that all of MDP's portfolio companies rely on other sources of capital besides private equity. These alternative sources of capital, such as bank credit facilities, provide an important source of liquidity and funding to competitive carriers and help to reduce the carriers' overall cost of capital. However, bank credit facilities, unlike equity capital, subject the borrower to rigorous performance requirements called "covenants." If the borrower fails to meet these, typically financial, performance measurements, the borrower "violates" the covenant. When a borrower violates the terms of a credit facility, the lender is free to discontinue access to the unused credit line, and can demand immediate repayment of any money borrowed. One of the most common financial benchmarks used as a covenant is earnings before interest, depreciation and taxes, which is a direct function of gross margin. Thus, the end result of any elimination of access to ILEC UNEs by the FCC is likely to be that competitive carriers fortunate enough to have access to existing credit facilities will likely lose access to these funds. Moreover, once a carrier's credit facility has been terminated by

one lender, it is extremely difficult to replace without a substantial new infusion of equity capital.

16. When discussing cost of capital, it is helpful to note that equity, as opposed to debt, is the most expensive type of capital; and private equity is the most expensive form of equity capital, requiring minimum returns of 30-40% per year. As a practical matter, the only "new" capital available to competitors is private equity capital, and not many competitors are likely to be able to realistically promise the returns to capital sufficient to justify pure private equity capital funding. Because the cost of what little "new" capital available to competitive carriers is so expensive, I do not believe it is likely that competitive carriers will be able to attract sufficient capital to replicate ILEC facilities currently purchased as UNEs if the FCC chooses to eliminate access to these network components.

17. While the elimination of UNEs on which MDP's portfolio companies directly depend will clearly effect our retail CLECs in substantial and obvious ways, what is not so clear is that even carriers that do not directly depend on ILEC UNEs will be effected negatively, and collaterally, by the premature elimination of access to ILEC UNEs. For example, our portfolio company Looking Glass Communications is a competitive metro wholesale provider and frequently sells to CLECs seeking alternative metro transport to the ILEC. Any weakening of the financial condition of Looking Glass' CLEC customers will, in short order, impute to Looking Glass, which is likewise at the mercy

of financial performance targets set based on previous regulatory presumptions.

18. At first glance, one may intuit that the restriction of available transport as a UNE would be a positive for alternative providers of this service. However, such a conclusion would be wrong. The existence of competitive CLECs is a necessary, but not sufficient, predicate to entry into the market as a metro wholesale provider. Therefore, the existence of healthy CLEC customers is essential to the survival of a metro wholesale carriers' carrier. Furthermore, it should be noted that neither Looking Glass nor any other metro wholesale provider that I am aware of possesses a metro transport network of sufficient ubiquity to be a complete substitute for access to the ILEC transport UNE.

19. The reason I say that the existence of a healthy CLEC segment is critical, but not essential to competitive wholesale entry into metro markets, is to avoid leaving the Commission with the wrong impression that an overall increase in transport prices available to CLECs will attract more entry by metro wholesale carriers' carriers. If the immediate impact of a phase out of access to a UNE is to weaken CLECs, the preconditions for competitive entry will weaken. Similarly, even if retail CLECs were able to "hang on" for a while, paying the higher ILEC special access rates, the result would not necessarily stimulate entry by wholesale carriers' carriers, because these firms' entry decisions are guided by the overall size of the market they can address, which includes demand from IXCs, ISPs, value added service providers, and wireless carriers, *in addition to* expected revenue from CLECs. Moreover, as

explained above, the scope of entry by competitive facilities-based transport wholesalers is rarely, if ever, ubiquitous enough to provide an alternative for the majority of CLEC transport demand.

20. I believe this is a critical yet often overlooked point. If ILEC UNEs were to be eliminated based on the presence of some alternative source such as Looking Glass, the elimination of the ILEC UNEs and corresponding adverse impact on CLECs could have the perverse effect of eliminating the alternative source itself from the marketplace for it can no longer survive without viable CLECs. Thus, the Commission should not really consider the elimination of any UNE based on alternative sources in a marketplace without considering the long term viability of the alternative sources.

21. A similar, analogous situation to the one just described is the potential negative effect on MDP portfolio companies due to the *indirect* loss of UNEs on which the precious few competitive wholesale providers depend. As I explained above, some competitive wholesale providers enter the market as pure wholesalers, and some of these carriers (like Looking Glass) use entirely their own facilities. Some competitive wholesale carriers, however, do use ILEC UNEs such as dark fiber (although MDP's portfolio companies typically do not), which these carriers light and make available to retail competitive carriers like MDP's other portfolio companies. Examples of these companies include El Paso Networks and OnFiber Carrier Services. Companies such as these are important to MDP's portfolio companies, because they contribute to gross margin by allowing our retail carriers to reduce costs and/or increase

revenues by offering better, different, or cheaper services to the retail end-user.

22. Similarly, there are other, primarily retail CLECs, who also own their own competitive facilities. If these retail carriers have excess capacity, they often find it profitable to provide such capacity to other competitive carriers on a wholesale basis. These carriers may use more, or different, UNEs than MDP's portfolio companies. Examples of these types of carriers include ITC^DeltaCom and WorldCom, both of whom provide wholesale services to MDP portfolio companies, and both of whom depend on the continued availability of other ILEC unbundled network elements (which MDP's portfolio companies do not use) to support their own revenue growth and, therefore, compliance with their own covenants with their funding sources. Likewise, these carriers, too, provide valuable contributions to our portfolio companies' ability to maintain, or expand, our existing gross margins.

23. Were the FCC to eliminate, or phase out, the availability of these UNEs to our companies' carrier-suppliers, the collateral effects on MDP's portfolio companies would likely be less substantial, but could be equally profound, depending upon the benefits that any of our companies receives from a particular carrier-vendor negatively affected by a Commission decision to eliminate other UNEs. While I cannot easily quantify the collateral risks to any given MDP portfolio company from the removal of any particular "indirect" UNE, I can assure the Commission that if other companies and their investors lose money with the "stroke of a pen," the Commission will have

closed the door on future competitive investment. While MDP will remain committed to those of its portfolio companies which seem likely to be able to continue to execute their business strategies, MDP will most likely be reluctant to commit our investors' capital to new ventures, regardless how innovative the proposed service or technology appears to be. The possibility that the Commission may, in another three years, take further action to jeopardize competitive investment would likely forestall any significant investment in competitive telecommunications service providers for the foreseeable future.

24. Thus, I must respectfully suggest that the FCC is misguided if it believes that it can forcibly stimulate more competitive investment than the market can currently bear (under a relatively favorable regulatory environment), by further restricting access to ILEC UNEs and, thereby, increasing capital costs to all competitive carriers. To the contrary, by restricting, rather than increasing, access to ILEC UNEs in this proceeding, the Commission may very well devalue existing competitive investment, discourage further competitive investment, and erect new barriers to future facilities-based competitive entry. This concludes my declaration.

James N. Perry, Jr.
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Three First National Plaza, Suite 3800
Chicago, IL 60602

Dated: 7/5/02

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DECLARATION OF JOHN HUNT IN SUPPORT OF THE REPLY COMMENTS OF THE COMPETITIVE TELECOMMUNICATIONS ASSOCIATION

1. My name is John Hunt. I am a Managing Director at the private equity firm of Boston Ventures ("Boston Ventures"), One Federal Street, Boston, MA 02110. Boston Ventures is a private equity firm, specializing in providing later stage equity capital to private companies. Boston Ventures, currently, has a substantial equity stake of $52 million invested in a competitive local exchange carrier called Integra Telecom ("Integra"). I am also a director on the board of Integra Telecom. The purpose of my affidavit is to support the Reply Comments of the Competitive Telecommunications Association, and to explain why any reduction in the future availability of incumbent local exchange carrier unbundled network elements ("ILEC UNEs") as a result of this proceeding will jeopardize past and future investment in facilities by competitive carriers.

2. Boston Ventures became involved with Integra Telecom when we were approached by an investment bank over two years ago. The basic premise of Integra's business plan seemed sound. The company was a small, independent local exchange carrier, interested in expanding their business by entering urban markets as a CLEC to serve the traditionally underserved small and medium business customer segment of the market. Integra uses a direct sales force and focuses on customers who require data as well as voice service. Furthermore, Integra uses a so-called "smart build" CLEC entry strategy, where the carrier owns its own switches and collocations, and purchases loops and usually dedicated transport from the incumbent LEC.

3. Among the points that convinced Boston Ventures that Integra was a good investment opportunity were: the experience of Integra's management team, their relatively capital-efficient entry strategy, the favorable regulatory environment as a result of the government encouraging local competition, and the large telecommunications market, so that even a carrier with a very small share of the market seemed likely to capture a relatively large amount of revenue. At present, we are satisfied that Integra is performing consistent with our expectations, considering the poor economic conditions facing all telecommunications carriers. Absent a significant negative change in one of our fundamental assumptions regarding Integra, or in the pro-competition policies of the government, Boston Ventures remains committed to our investment in the competitive telecommunications industry.

4. One such change that Boston Ventures would regard as significant and negative, would be if an exogenous legal, or regulatory, event were to increase the operating costs or capital expenditures necessary to continue Integra's business operations. One example that I was asked to consider was the possible effect of the premature removal of a network element upon which Integra depends in order to provide service to its customers. Specifically, I was asked whether the removal or "phase out" of a particular UNE would cause Integra to invest more capital in the construction of its own facilities as replacements for the ILEC facilities Integra was leasing, or would have leased, as UNEs.

5. I wish to make this one point perfectly clear: even if replication of ILEC facilities, currently leased as UNEs by Integra, would ultimately lower Integra's incremental costs to serve its customers, Boston Ventures would not fund such an increased capital requirement at this time. Therefore, any decision by lawmakers, or regulators, that would materially increase the capital requirements necessary to continue to operate Integra Telecom would, in my opinion, be more likely to hasten the exit of those assets from the market than to stimulate more investment in competitive facilities.

6. There are several reasons why Boston Ventures would not respond "favorably" to any exogenous increase in funding requirements by the government, even if the result of those increased funding requirements had a neutral or positive effect on operating margins. Said differently, even if the government could show to certainty, that competitors could operate more

efficiently by using their own, self-provisioned, facilities than they could by leasing the same facilities as UNEs from the ILEC, Boston Ventures would, at present, be unlikely to fund such a capital expenditure by Integra Telecom.

7. As an initial matter, Boston Ventures is not yet convinced that the competitive local telecommunications industry is a "viable" industry, even given present capital demands. By the term "viable" I mean capable of supporting carriers that are "free cash flow" positive, which, in turn, means that a carrier can operate without further infusions of outside capital. In other words, given the existing state of the industry, Boston Ventures will be wary of investing additional capital in competitive carriers unless, or until, those carriers can demonstrate that they are capable of becoming "free cash flow" positive.

8. Were the FCC to increase the amount of capital necessary for competitive carriers to demonstrate viability the prospect of attaining this status would, for most competitors, likely become even more remote. However, the concern created by such an FCC decision, that the government could again, in only three more years, decide to further increase funding requirements on investors to build ever more competitive facilities would likely be more damaging to the future viability of facilities-based competition than even a decision to increase capital funding requirements on existing market participants. Indeed, the prospect that the government could, and would willingly, extend "payback" periods for competitive investors indefinitely would cause Boston Ventures—and, in my opinion, most other investors—to exit this sector entirely.

9. In my opinion, the present state of the industry for investors is analogous to a situation where a lender has made a somewhat risky decision to fund furniture for a person renting a house. Let us say that the renter is barely able to pay the lender and the landlord at present. With a large enough down payment, the renter could certainly purchase the house, and thereby lower their monthly payments. Yet, if the existing lender has concerns about the ability of the renter to repay its current debts, it is highly unlikely that the lender will provide the renter with substantial new funds necessary for a down payment on a house.

10. In a situation like that just described, a decision by the government to phase out the practice of renting, and to require all current renters to purchase their own homes within a certain period of time, would likely create more homeless people than home owners. Similarly, in the present proceeding, the government must decide whether to let the evolution of competitive networks continue to develop under the legal and regulatory assumptions on which these investments were initiated, or whether additional capital spending can be extracted in a poor economic environment by government fiat. While Boston Ventures has sought, and will continue to seek, opportunities to reap higher returns for our investors through the acceptance and management of financial risk, Boston Ventures can neither anticipate, nor manage, the risk of fundamental governmental policy changes due to regulatory caprice. Thus, Boston Ventures encourages the FCC to continue the pro-competitive, pro-

unbundling, policies that have been in effect since the adoption of the Telecommunications Act of 1996.

11. Lastly, the capital markets have changed significantly since Boston Ventures first invested funds in Integra. Simply put, capital markets today are closed to significant new investment in competitive telecommunications ventures. In this environment, self-provisioning is not a viable solution for a competitive local provider if it requires any significant capital market funding. As a result, any decision by the FCC that would explicitly or effectively require competitive local telephone companies to engage in more self-provisioning will weaken these competitors, if not force them to exit the market. There is no scenario that I can envision given today's capital markets where an increase in self-provisioning for any UNEs is feasible. This concludes my declaration.

John Hunt
Managing Director
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One Federal Street, 23rd Floor
Boston, MA 02110-2003

Dated: 5.13.02

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DECLARATION OF PETER H. O. CLAUDY IN SUPPORT OF THE REPLY COMMENTS OF THE COMPETITIVE TELECOMMUNICATIONS ASSOCIATION

1. My name is Peter H. O. Claudy. I am a General Partner in the private equity firm of M/C Venture Partners ("M/C" or "M/C Ventures") 75 State Street, Boston, MA 02109. M/C Ventures is a private equity firm, specializing in providing early stage equity capital to telecommunications and information technology firms. Currently, through our three active funds, M/C has over $1 billion of equity capital under management, the large majority of which is invested in competitive telecommunications carriers. M/C has been actively involved in the telecommunications sector for over 20 years, and has been a pioneer in the financing of competitive carriers in the local exchange marketplace. One example of our early involvement in this sector is that we were the largest, and first, venture capital investor in Brooks Fiber Communications; making our investment in 1993.

2. After enactment of the Telecommunications Act of 1996, M/C began to focus on competitive carriers targeting residential and small-to-medium business consumers. M/C believed then, and continues to believe now, that there are significant opportunities for private equity firms to create value for investors through the creation and development of competitive telecommunications markets. In fact, M/C Ventures believes so firmly in this fundamental principle that it has also invested "upstream" to fund carriers providing service to competitive local exchange carriers ("CLECs").

3. As a private equity investor, M/C Ventures raises pools of capital from other investors, who agree to commit their capital to an M/C Ventures fund for a minimum of 10 years. Once a fund is created, and an investor commits their capital, the investor is called a "limited partner." The principals of M/C Ventures are the "general partners" in the investment partnership. M/C must, for its part, identify investment opportunities, make investments in these companies, manage these investments, and, ultimately, successfully convert the fund's equity share into a more liquid asset (such as cash or stock in a publicly-traded company), which is then distributed among the fund's limited partners. M/C Ventures is not successful unless we can, over the life of a fund, realize capital gains for our limited partners' investments.

4. While M/C Ventures is always evaluating new investment opportunities on behalf of both its limited partners, and its existing portfolio companies, M/C is currently focused on managing primarily four substantial portfolio companies in the competitive telecommunications service provider sector. Three of these

companies, McLeodUSA, Cavalier Telephone, and Florida Digital Network, are retail CLECs offering integrated communications services (local and long distance voice and data) to residential and small/medium business customers. One other major portfolio company, City Signal Communications, provides dark fiber to other, primarily competitive, telecommunications carriers. While M/C Ventures understands the importance, and value, of minimizing its portfolio companies reliance on incumbent local exchange carrier ("ILEC") unbundled network elements ("UNEs"), all of our portfolio companies have some critical dependence on each of the currently-defined ILEC UNEs.

5. To be more clear, let me provide a brief description of the business strategy being employed by each of the four M/C Ventures portfolio companies previously identified. McLeodUSA is an integrated communications provider serving small to medium business customers throughout mid-west and north-west United States. McLeod uses a combination of strategies and service configurations, from UNE-P (loop-switch-shared transport) to UNE-Loop + own switch + ILEC/CLEC/self-provisioned transport, depending on how a customer in any given location throughout their extensive service territory is most efficiently served. FDN serves small/medium business customers in Florida only; Cavalier serves the residential and business customers in Virginia, Maryland, Pennsylvania and Delaware. Both Cavalier and FDN use ILEC loops combined with their own switch and their own, another CLEC's, or an ILEC's dedicated transport. Cavalier has more route miles of company-owned fiber transport, and therefore, is less dependent on the ILEC, or other

competitive carriers, than is FDN. Finally, City Signal provides dark fiber services primarily to other carriers entirely using the company's own dark fiber facilities. As I will explain later, all of these carriers are critically dependent on the continued availability of, at a minimum, all existing ILEC UNEs.

6. The purpose of my declaration is to provide evidentiary support for the Reply Comments of the Competitive Telecommunications Association ("CompTel"), of which some of our portfolio companies are members. I will explain, generally, why it is important for purposes of both preserving existing competitive investment, as well as opportunities for future competitive investment, that the FCC not eliminate any UNEs that are currently available to competitive carriers. I will also explain why some of the changes to the current "impairment analysis" that the Commission suggests it will consider, do not, and cannot, adequately support the diversity of both existing, and future, competitive carriers that must rely on ILEC UNEs, either directly or indirectly, to provide valuable and innovative services to American consumers. Finally, I will explain the likely effects of a Commission decision to remove an ILEC UNE, on which any group of competitive carriers remains dependent.

7. As a private equity investor funding many "facilities-based" competitive carriers, M/C Ventures is worried that the FCC, despite its professed commitment to competition, is, by the very breadth and scope of its review of UNEs, jeopardizing all competitors. Paradoxically, a frequent and broad scale

review of the UNE rules disproportionately exposes "facilities-based" CLECs and competitive network providers to regulatory and financial risk. The bases for my concerns are many, but, as an initial matter, I would like to explain how investors analyze and evaluate investments in high-fixed-cost, network-based industries like telecommunications.

8. As I mentioned earlier, all of M/C Ventures' funds have a 10 year life; however, this is a minimum, and can be extended if the general partners desire to do so. In my experience, in working with not only the wireline, but also wireless, telecommunications sectors such extensions of fund lives are often necessary in order to extract the most value for our limited partners. For example, it may take many years to build out a network, and many years after that before a company has enough customers and revenue from the network for the company to be an attractive acquisition candidate to either another carrier or issuer to the public equity markets. Usually, this will not occur until a company has built its network, acquired sufficient customers, and become "free cash flow" positive—which means that the company can survive at its existing scale and scope without future cash infusions from outside investors. If a project is abandoned at any point prior to the point of viability just described, the likelihood of an investor even recouping a portion of the original investment, much less the investment with a risk-adjusted return, is severely diminished.

9. As a private equity investor in the competitive telecommunications sector, actively funding substantial network construction, M/C Ventures was given

cause for concern when the FCC announced such a comprehensive re-examination of the rules and standards regarding competitive carriers' access to ILEC UNEs. M/C Ventures is concerned that the FCC may jeopardize substantial capital investments which were predicated on competitive carriers continuing to be able to access critical "core" portions of the ILEC network—including very "basic" network elements such as loops, switching, and dedicated interoffice transport.

10. In light of the Commission's willingness to undertake such a complete and comprehensive re-examination of its rules every 3 years, M/C Ventures will have to carefully consider future business plans that require reliance on any ILEC facilities for periods greater than 2 years. Further, I do not believe that M/C Ventures, or any other private equity investors, will be likely to fund substantial investments in new network construction and infrastructure. This is because substantial network investments often take longer than 2-3 years to construct, much less reach the point of being free cash flow positive. Therefore, M/C Ventures would be reluctant to fund new network construction, unless we were confident that planning stage assumptions predicated on longer-term availability of ILEC UNEs were not misplaced. Because it is simply not possible, or economically feasible, to overbuild the existing switched public telephone network to such a degree that investors would be protected from regulatory risk, the FCC should not adopt any further review at pre-determined intervals (three years or otherwise). Such frequent

regulatory review will limit the ability of new entrants to obtain the financing they need to enter and sustain entry.

11. I am also concerned that the FCC might be seeking to eliminate access to certain critical UNEs on a so-called "granular" or market-by-market basis. This is troublesome, only partly because the FCC asks questions regarding the appropriate product and geographic markets with respect to the consumer, and not the requesting carrier. I am also concerned that, even if the Commission were attempting to define UNE "markets" by focusing on the CLEC customer, the concept of what would be an appropriate way to eliminate UNEs on a geographically-limited basis is, itself, problematic.

12. The geographic area within which a competitive carrier will require access to ILEC UNEs depends on what type of customers are being targeted and the carrier's capital expenditures. For example, a competitor seeking to serve a limited number of customers through total service resale, could likely enter on a much more geographically-limited basis than a carrier making a more substantial capital investment. At the same time, a carrier seeking to serve other carriers off of its own network may have to enter a minimum of 25, or more, cities throughout the country in order to have enough addressable wholesale customers to hope to attain profitability in the time period that its investors have set.

13. Additionally, the minimum viable scale of entry for any given carrier will also depend on what stage of its business plan execution that it is in at any given moment. A new entrant, even one with ambitious network facilities build-out

plans, will necessarily need greater access to ILEC UNEs than a carrier on the last stage city of a 40 city network. Because of the inherent risks and difficulties in tailoring geographic restrictions on UNE availability to only those areas where the UNE in question is practicably available from a third party, the Commission should carefully consider any decision to restrict UNE access on a geographic basis.

14. The FCC should also only consider restricting access to any UNEs if an obvious and active wholesale market clearly exists for the element. The idea that "self-provisioning" is a viable substitute for an ILEC UNE is completely divorced from market realities. Every carrier implementing its business plan is already "self-provisioning" every element that the investors, debt holders, and commercial lenders have authorized. A CLEC who is denied access to a UNE critical to implementing its entry plan cannot simply "self-provision" that element without express authorization and an additional funding commitment by the company's financiers. Indeed, such a change in strategy would constitute a material change in the entities business plan, that would, even if ultimately approved, need to be reviewed by all debt and equity holders. However, in my opinion, it is extremely unlikely that in the present economic climate, any competitive carrier would be able to secure approval for a material change in a business plan that required *additional* investment to implement essentially the same plan.

15. My primary concern that the Commission not attempt to restrict access to UNEs is that the *consequences* of the elimination of access to ILEC UNEs is,

at the moment, likely to be particularly severe for the entire competitive telecommunications industry. One issue, in particular, that the Commission does not seem to consider in its NPRM is the effect of the elimination of access to network elements on the bank lending covenants of competitive carriers.

16. All competitors depend on a variety of financing sources. Carriers get the bulk of their investment capital from private equity and debt investors. However, carriers are also dependent on commercial bank credit facilities in order to fund working capital and capital expenditures. These credit arrangements entitle the borrower to "draw down" a line of credit until the maximum amount of credit is borrowed. However, in order to continue to be able to access the credit facility, the borrower must meet certain, pre-set "covenants," or performance targets. These targets are frequently common barometers of financial performance such as revenue, gross margins (revenue minus cost of goods sold), EBITDA (earnings before interest, taxes, depreciation, and amortization) and capital expenditures. Covenants can also include industry-specific targets such as access line count.

17. If a borrower "violates" a covenant by failing to achieve the performance targets, the lender may cancel the credit facility and demand immediate repayment of the borrowed amount. Such recourse typically has disastrous consequences for the borrower, because when a lender terminates a credit facility, the borrower is effectively foreclosed from accessing the credit markets. In my experience, once a bank has terminated a credit facility, other

banks are reluctant to extend credit, absent a restructuring of debt, an equity infusion, or both.

18. My concern with the FCC's articulated willingness to consider eliminating access to UNEs on a geographic market basis is that a heretofore solvent, performing carrier could be pushed into default at the stroke of a pen. This, in-turn, could easily spark a "domino effect" within the carrier's carrier segment of the competitive telecommunications industry. I will illustrate this concern using a hypothetical example with two of M/C Ventures' portfolio companies.

19. Let us assume that the FCC eliminates DS3 transport in the top 50-100 MSAs. Assume also that FDN, while operating throughout Florida, has a large percentage of its access lines in a few top MSAs where it is heavily, though not exclusively, dependent on ILEC transport. Elimination of the UNE transport element would require FDN to purchase its DS3 transport as a tariffed service, causing an approximate doubling in its costs for that element.

20. As a result, FDN's gross margins would shrink by some amount. In an already poor economic environment, this could easily lead to FDN breaching its lending covenants. Immediately, banks would terminate credit facilities.

21. Let us further assume that FDN was using the dark fiber of City Signal where it could, as a substitute for ILEC facilities. FDN would have to inform City Signal, as well as other creditors, that it would not be able to make payments on time. This, depending on the number and size of City Signal's customers affected, could also imperil City Signal's lending covenants, because another

measure that lenders frequently require as a covenant is the amount of accounts receivable past 90 days.

22. In summation, I hope I have adequately explained the following points: 1) investors in competitive enterprises have longer time horizons than the three year review period the Commission has established for its UNE rules, and investor's time horizons are positively correlated with the size of the investment in the competitive carrier—the larger the investment, the more likely the network will take longer than three years to be constructed and become free cash flow positive; 2) geographic restrictions on UNEs necessarily require the Commission to make a "one size fits all" determination—at one point in time—of the type, size, and stage of development of a CLEC that will, by regulatory fiat, be allowed to survive, notwithstanding the CLEC's perceived value by its investors, customers, and employees; 3) elimination of existing UNEs, for which any class of carrier is dependent—even if done on a finite and geographically-limited basis—will jeopardize those carriers, and may have unintended negative consequences for other carriers. This concludes my declaration.

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Competition keeps calling, but local Bells resist

In Michigan last month, something rare and unexpected showed up in more than 2 million mailboxes: a lower local phone bill. The state's Bell company, SBC Ameritech, cut the monthly charge for its unlimited local calling service by a third — from $21 to $14. Overall, Michigan customers will save about $26 million a year.

But in West Virginia, customers are still paying $22 a month. Why the difference? In a word: competition.

In Michigan, SBC's competitors serve more than 13% of the phone lines, nearly double their market share a year ago. And rivals keep picking up business. AT&T alone has signed up 150,000 customers in the past three months.

By contrast, West Virginia's local Bell company, Verizon, holds all but 3% of the phone lines, according to the Federal Communications Commission (FCC).

How did Michigan do it? The state required SBC to charge a fair price to other phone companies that need access to SBC's phone lines and switches to compete for local phone service. New Jersey followed suit on Monday, joining a few other states. They recognize that this holds the best hope for competition, despite fierce opposition from the local Bells.

Congress paved the way for a competitive landscape way back in 1996. The Telecommunications Act set out to break the regional Bells' stranglehold on local markets. One way to do that was to let competitors lease parts of the Bell network. Competitors can, for example, rent space on the wires and switches that connect calls to homes. For too long, though, the rental fees the Bells could charge competitors for access to the network were exorbitant. Little competition actually emerged.

In 2000, Michigan's Public Service Commission ordered SBC to lower its access fees. That gave AT&T, MCI and several small local phone companies the chance to break into the market.

Other state utility commissioners are beginning to take similar steps. Last October, Ohio lowered rental fees, saying it would "open the door for more local telephone competition." New York followed last January. In May, California cut rental fees by 40%. And on Monday, New Jersey cut its fees roughly in half. That prompted AT&T to announce plans to jump into both the local California and New Jersey markets later this summer.

The resulting competition should pay off for consumers. Competition in New York saves phone users there $700 million a year, according to a study by the Telecommunications Research & Action Center.

None of this progress, though, comes without a fight. SBC battled the Michigan Public Service Commission's effort to lower fees for years. Soon after Ohio cut its charges, SBC launched a lobbying campaign to double them. Among SBC's more ludicrous warnings: The price cut could jeopardize charitable donations in the state. In Pennsylvania, Verizon wants to sharply hike the fees it can charge competitors.

The Bells argue that lowering these fees discourages competitors from building their own networks, since they can just ride off the Bells' for cheap. The Bells also claim that low fees force them to rent their equipment at a loss during a period when the telecommunications industry is suffering a downturn.

What the Bells really fear is the loss of their monopoly grip on local markets and the high phone rates it lets them charge. Rates for local phone service have climbed faster than inflation since 1997, according to the FCC. That's in sharp contrast to hotly competitive long-distance and cell phone services, which have seen prices plunge.

Stanching competition has been the sorry pattern of the Bell companies since the 1996 law was passed. They have filed suits challenging key provisions of the law and its implementation. Their attempts to undermine competitors have cost them millions in fines. In June, for example, Minnesota regulators hit Qwest with a $900,000 fine for anti-competitive behavior.

The Bells also have failed to live up to promises to compete made in exchange for lucrative merger deals. SBC pledged to aggressively invade 30 markets outside its region after it merged with Ameritech in 1999. Verizon said its merger with GTE two years ago would give it a platform to directly challenge other Bell companies. Those battles have yet to be waged.

Michigan and a few other states have shown the way to get competition rolling. Now other states need to join in. Six years is too long to wait for local phone competition.